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American Institute of Certified Public Accountants. Audit Standards Team

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# In Our Opinion...

The Newsletter of the AICPA Auditing Standards Team

Vol. 12 No. 2

April 1996

## ARSC Considers Comment Letters on "Assembly" Exposure Draft

by Judith M. Sherinsky

The Accounting and Review Services Committee (ARSC) met on February 15-16, 1996 to discuss issues raised in the over 500 comment letters on the exposure draft of a proposed Statement on Standards for Accounting and Review Services (SSARS) titled, *Assembly of Financial Statements for Internal Use Only*. The proposed Statement was exposed for comment in September 1996, and would exempt CPAs from the reporting and procedural requirements of SSARS No. 1, *Compilation and Review of Financial Statements*, when assembling internal-use only financial statements for their clients. SSARS No. 1 requires that an accountant, at a minimum, compile financial statements submitted to a client or others, and report on them accordingly.

The proposed Statement defines the assembly of financial statements as:

Providing various manual or automated bookkeeping or data processing services the output of which is in the form of financial statements intended for internal use only. The function of assembling financial statements may include preparing a working trial balance, assisting in adjusting the books of account, and consulting on accounting matters. Assembly does not refer to the mere typing or reproduction of client-prepared financial statements.

In an assembly service, the accountant would be required to establish a written understanding with his or her client that includes—

- A description of the nature and limitations of the services to be performed
- A confirmation of management's representation and agreement that the financial statements are for internal use only
- A statement that the engagement cannot be relied upon to

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## The Auditing Standards Board Establishes New Task Forces

by Patricia A. Cummings

The Auditing Standards Board (ASB) has established four new task forces to address emerging audit issues. The new task forces are as follows:

- The **SAS No. 7 Task Force** will consider revising Statement on Auditing Standards (SAS) No. 7, *Communications Between Predecessor and Successor Auditors*, and the related interpretations to (1) address the successor auditor's responsibility with respect to obtaining sufficient competent evidential matter in order to express an opinion on the financial statements under audit, (2) reconsider the scope of working papers that may be reviewed by a successor and related arrangements for such review, and (3) consider such other related matters as may be identified by the task force. This task force is chaired by Stephen McEachern and is staffed by Kim Gibson.

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American Institute of Certified Public Accountants

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## ARSC Considers Comment Letters on "Assembly" Exposure Draft *(continued from page 1)*

disclose errors, irregularities, or illegal acts

The accountant would not be required to report on the assembled financial statements. However, the proposed Statement would provide the accountant with the option of enclosing a transmittal letter with the financial statements, if the contents of the letter were limited to —

- An identification of the financial statements enclosed
- A reference to the fact that the financial statements are for internal use only pursuant to the terms of the engagement letter
- Comments of a business advisory nature to which the accountant wishes to draw the client's attention

To reduce the risk of misunderstanding, the proposed Statement recommends that language or style similar to that used in a compilation report be avoided. The proposed Statement also provides the accountant with the option of placing a legend on each page of the financial statements indicating that the statements are restricted to internal use and referring the reader to the engagement letter.

Proponents of the assembly service believe that many nonpublic entities do not need financial statements that comply in all material respects with generally accepted accounting principles (GAAP) or an other comprehensive basis of accounting (OCBOA) if the statements are for internal use only. As stated

previously, existing standards require that CPAs who submit financial statements to their clients or others at least compile the financial statements and report on them accordingly. If the financial statements contain departures from GAAP or an OCBOA, the CPA is required to cite those departures in a separate paragraph of the compilation report. Proponents of the proposed Statement believe that these requirements add unnecessary time and cost to engagements.

Opponents of the proposed Statement agree that many nonpublic entities may not need financial statements that comply in all material respects with GAAP or an OCBOA. However, they believe that the proposed Statement does not establish a minimum level of adherence to GAAP or an OCBOA and therefore permits an unacceptably lower range of financial statement quality. By not requiring the accountant to identify the departures in the financial statements, financial statement users may be misled. (Many commenters on both sides of the issue believe that it is likely that assembled financial statements will be submitted to third parties, such as bankers.) Opponents of the proposed Statement also believe that an assembly service is not needed because existing standards provide the accountant with various options

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## The Auditing Standards Board Establishes New Task Forces

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The SAS No. 7 Task Force is scheduled to hold its first meeting in April 1996.

- The **Existence, Ownership, and Valuation Task Force** was created to consider providing guidance for the auditor's responsibility for auditing ownership, existence valuation, and related disclosures of financial instruments, commodity contracts, and similar instruments when a third party performs services for an entity such as maintaining custody or investing assets. This task force is chaired by Luther "Tom" Birdzell and is staffed by Patricia Cummings. The Existence, Ownership, and Valuation Task Force is scheduled to discuss the scope of its work with the ASB at the ASB's April 1996 meeting.
- The **SAS No. 19 Task Force** was formed to consider amending or revising SAS No. 19, *Client Representation*, including related

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### Upcoming ASB Meetings

ASB meetings are open to the public. For ASB agenda information, call 1-800-TO-AICPA

April 2-4, 1996 New York, NY

June 25-27, 1996 Philadelphia, PA

August 20-22, 1996 New York, NY

## **ARSC Considers Comment Letters on "Assembly" Exposure Draft** *(continued from page 2)*

for performing less complex and less time-consuming compilations such as compiling cash-basis financial statements with substantially all disclosures omitted.

After discussing the views expressed in the comment letters, ARSC concluded that it needs additional information from CPAs who support the exposure draft about the types of problems they encounter when attempting to comply with the requirements of SSARS No. 1. ARSC plans to write to commenters who supported the proposed SSARS and to call a sample of those practitioners to obtain the needed information.

ARSC also concluded that the comment letters reveal elements of SSARS that require clarification because they create practice problems

for CPAs performing compilation engagements. CPAs appear to have differing interpretations of the meaning of certain sections of SSARS, particularly sections concerning the submission of financial statements. ARSC believes that these problems require attention and may amend or interpret SSARS No. 1 to clarify sections that create diversity in interpretation or that are subject to misunderstanding.

At its next meeting on May 2–3, 1996, ARSC will continue to consider issues raised in the comment letters and will also discuss issues related to the electronic submission of financial statements with an ad hoc task force that is examining the effect of electronic transmission on financial statements and accountants' reports.

## **The Auditing Standards Board Establishes New Task Forces**

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interpretations to reflect current practice and current generally accepted accounting principles. This task force is chaired by James Gerson and is staffed by Judith Sherinsky. The SAS No. 19 Task Force will begin its work later this year.

- The **Attestation Recodification Task Force** was formed to evaluate the Statements on Standards for Attestation Engagements to determine whether the framework for such standards needs to be amended, interpreted, or modified. This task force is chaired by W. Ronald Walton and is staffed by A. Louise Williamson. The Attestation Recodification Task Force will

## **Highlights of Technical Activities**

The ASB is currently involved in numerous projects. Listed below are some of the task forces of the ASB and a short summary of each task force's objective and current activities.

### **SAS Task Forces**

**Auditor Communications** (Staff Aide: A. Louise Williamson). The task force is studying the auditing and attestation standards dealing with the auditor's or practitioner's communication responsibilities, other than reporting, to determine whether revisions to the standards or additional guidance is needed. The task force is also considering whether standards should be established that provide guidance on developing an

understanding with a client about the nature, scope, and limitations of the services to be performed. The task force presented preliminary issues regarding obtaining an understanding with the client at the January 1996 ASB meeting. The task force plans to continue this discussion at the April 1996 ASB meeting.

**Auditing Investments Task Force** (Judith M. Sherinsky). The task force is revising AU section 332, *Long Term Investments*, to make the guidance in that document consistent with Financial Accounting Standards Board Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*.

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## Highlights of Technical Activities (continued from page 3)

The revised standard will address the auditor's responsibility for auditing debt and equity securities, including investments accounted for under the equity method of accounting. At the January 1996 ASB meeting, the ASB discussed a revised draft of the proposed standard titled, *Investments in Debt and Equity Securities* and voted to ballot the draft for exposure.

**Electronic Evidence Task Force** (A. Louise Williamson). The task force is considering whether existing guidance regarding evidential matter in the audit and attestation literature requires revision, given that a significant amount of evidential matter is currently in electronic format. The task force is also (1) evaluating how the auditor's responsibility for the detection of material misstatements in the financial statements, including the detection of fraud, may be affected by electronic evidence, and (2) considering whether there is a need for non-authoritative guidance dealing with electronic evidence. At the November 1995 ASB meeting, the task force presented proposed revisions to SAS No. 31, *Evidential Matter*, to reflect electronic evidence considerations. At this meeting, the ASB voted to ballot this document for exposure. The exposure draft is expected to be issued in the second quarter of 1996.

**Fraud** (Jane M. Mancino). The task force is developing a proposed SAS that would clarify the auditor's responsibility for the detection of fraud and provide operational guidance for carrying out that responsibility. The proposed SAS would supersede SAS No. 53, *The Auditor's Responsibility to Detect and Report Errors and Irregularities*. At its January 1996 meeting, the ASB deleted the requirement to assess whether there is a heightened risk of fraud and replaced it with one to assess the risk of material misstatement due to fraud. The task force will bring a proposed exposure draft to the ASB for a vote to expose for public comment at its April 1996 meeting.

### SSAE Task Forces

**Management's Discussion and Analysis (MD&A)** (Beth Schneider/Deloitte & Touche LLP). This task force is developing an SSAE that would provide guidance on reporting on MD&A. In its deliberations, the task force is considering the 1987 exposure draft,

*Examination of Management's Discussion and Analysis*, and related comment letters, and the Comprehensive Model for Financial Reporting proposed by the AICPA Special Committee on Financial Reporting. At its January 1996 meeting, the ASB discussed issues and a draft report on examination of MD&A. The task force expects to present issues, draft procedures, and a revised examination report to the ASB at its April 1996 meeting.

**SEC Auditing Practice** (Jane M. Mancino). The task force monitors regulatory developments affecting accountants' involvement with financial information in filings with the Securities and Exchange Commission (SEC) and considers the need for, and develops as necessary, guidance in the form of SASs, SSAEs, auditing interpretations, or guides. Liaison with the SEC is maintained through the Audit Issues Task Force.

### Other Task Forces and Committees

**Accounting and Review Services Committee** (Judith Sherinsky). The committee is currently discussing issues raised in the over 500 comment letters on the exposure draft of a proposed Statement on Standards for Accounting and Review Services titled, *Assembly of Financial Statements for Internal Use Only*. (For additional information, see article titled *ARSC Considers Comment Letters on "Assembly" Exposure Draft* beginning on page 1.)

**Audit Issues Task Force** (Patricia A. Cummings). The task force meets on a monthly basis to assist the ASB Chair and the Auditing Standards Division staff with the technical review of audit issues.

**Computer Auditing Subcommittee** (Jane M. Mancino). The subcommittee is working on two auditing proce-

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### Update of Proposed SAS on Fraud

At its April 1996 meeting, the ASB voted to issue a proposed SAS, *"Consideration of Fraud in a Financial Statement Audit"*. The proposed standard will be widely distributed in mid-May.

**Stay Tuned for Further Updates**

## Highlights of Technical Activities (continued from page 4)

dures studies (APSs). One APS, *Auditing in a Client/Server Environment*, describes client/server computing and its possible effects on a financial statement audit. The second APS, drafted with the Canadian Institute of Chartered Accountants, describes Electronic Document Management and possible audit implications. The first APS will be issued in the third quarter of 1996 and the second in 1997.

**Environmental Issues Task Force** (Judith M. Sherinsky). The task force has drafted a chapter titled "Auditing Environmental Remediation Liabilities" that is included as an appendix in the Accounting Standards Executive Committee's exposure draft of the proposed Statement of Position (SOP), *Environmental Remediation Liabilities*. The guidance presents the recommendations of the task force regarding the application of generally accepted auditing standards to the audit of an entity's financial statements as it relates to environmental remediation liabilities. The task force will meet in April 1996 to revise the chapter to reflect certain comments expressed in comment letters on the proposed SOP.

**Forecasts and Projections Task Force** (Patricia A. Cummings). An ad hoc group of this task force is currently revising the AICPA Audit Guide, *Guide for Prospective Financial Information*, for SSAE No. 4, *Agreed-Upon Procedures Engagements*, and for the Private Securities Reform Act of 1995.

**International Auditing Practices** (Dan M. Guy/J. Eric Nicely). The current agenda of the International Auditing Practices Committee (IAPC) includes developing assurance standards and revising the International Standards on Auditing (ISAs) dealing with audit sampling and going-concern. A task force of the ASB has been comparing the ISAs with the SASs to identify instances when international auditing standards exceed U.S. auditing standards. This analysis will be included in the *Codification of Statements on Auditing Standards as of January 1, 1996*.

**Joint Task Force on Quality Control Standards** (Kim Gibson). In August 1995, the ASB issued two proposed standards that would supersede Statement on Quality Control Standards No. 1, *System of Quality Control for a*

*CPA Firm*, and its interpretations. The first standard, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, is a general standard that requires a CPA firm to have a system of quality control for its accounting and auditing practice. It describes the elements of quality control and other matters essential to the effective implementation of the system. The second standard, *Monitoring a CPA Firm's Accounting and Auditing Practice*, provides guidance on how a CPA firm can implement the monitoring element of a quality control system in its accounting and auditing practice. At its December 1995 meeting, the ASB agreed to ballot the proposed standards as final standards. The task force will continue working on a document that will provide CPA firms with guidance on how to implement and maintain a system of quality control. The task force anticipates that this guidance will be issued in the third quarter of 1996.

**Technical Audit Advisors Task Force** (Thomas Ray). The task force receives assignments, on an on-going basis, from the Auditing Standards Division staff and the Audit Issues Task Force. The task force is currently considering whether audit and attest guidance on restricted use and limited distribution reporting needs to be modified. The task force also is considering certain changes to the AICPA's Technical Practice Aids

*(continued on page 6)*

### Exposure Drafts Outstanding

Proposed Statements on Quality Control Standards entitled *System of Quality Control for a CPA Firm's Accounting and Auditing Practice* and *Monitoring a CPA Firm's Accounting and Auditing Practice* (Comment period ended November 20, 1995)

## Highlights of Technical Activities (continued from page 5)

### APS Task Forces

The staff of the Auditing Standards Division and members of the respective ASB task forces are currently developing or revising the following Auditing Procedure Studies:

*Analytical Procedures* (Staff Aide: Kim Gibson)

*Auditing in a Client/Server Environment* (Jane M. Mancino)

*Audits of Small Business* (Tom Ray)

*Audit Sampling* (J. Louis Matherne)

*Confirmation of Accounts Receivable* (J. Louis Matherne)

*Electronic Document Management* (Jane M. Mancino)

For additional information about Auditing Standards Division and ASB projects, call (212) 596-6036.

### Recently Issued Documents

**Auditing Procedure Study, *Audit Implications of EDI*/Product No. 021060JH**

**Audit Guide, *Consideration of Internal Control in a Financial Statement Audit*/Product No. 012451JH** (scheduled to be available in April 1996)

**Auditing Procedure Study, *Implementing SAS No. 70, Reports on the Processing of Transactions by Service Organizations*/Product No. 021056JH** (scheduled to be available in April 1996)

**Codification of Statements on Auditing Standards as of January 1, 1996/Product No. 059026JH**

**Codification of Statements for Accounting and Review Services as of January 1, 1996/Product No. 057167JH**

**Codification of Statements on Standards for Attestation Engagements as of January 1, 1996/Product No. 057266JH**

To order, write: AICPA Order Department, CLA3, P.O. Box 2209, Jersey City, NJ 07303-2209; order via fax, 800/362-5066, or call 800/862-4272 (option #1). Prices do not include shipping and handling. Have membership number ready.

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